INSTITUTE FOR

# WORLD ECONOMICS

HUNGARIAN ACADEMY OF SCIENCES

Working Papers

No. 144 May 2004

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# COMPARATIVE ANALYSIS OF COMPETITIVENESS: THE CZECH REPUBLIC AND HUNGARY – AN INSTITUTIONAL APPROACH

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# SUMMARY

This paper compares the competitiveness of Hungary and the Czech Republic. Of the different approaches to what constitutes competitiveness, it takes the institutional one, which is crucial to the behaviour of market actors. Weak legal institutions such as non-functioning bankruptcy legislation increase costs and decrease the ability of firms to compete. But there are obvious problems with measuring the quality of the environment for competitiveness. The three aspects considered are the political, the legal (including corruption) and the general economic environment. Global statistics are provided for each, such as the Index of Economic Freedom, followed by data that address specific questions, such as 'How many days a year do your managers have to spend dealing with state officials?' The survey results are intended to give an overall picture in each field.

The two countries seem to have similarly high levels of political freedom. Both are deemed generally free, according to all measures (with minor reservations). The situation is worse with the legal environment, where both lag substantially behind the Western countries, but the situation in the Czech Republic is worse. The findings on corruption are similar, where the situation is poor according to most sources, especially in the Czech Republic. The last chapter of the analysis is devoted to economic freedoms – especially regulation of the business environment. Both countries can be considered partly free. The regulation and bureaucracy-related costs seem higher in the Czech Republic.

The author has some doubts about the data quoted in the paper and these are discussed in the final section. They concern particularly the level of corruption, which appears to be significantly lower in surveys where firms answer direct questions about their behaviour. The second caveat concerns a sudden deterioration in the scores for the Czech Republic, connected with the recession after 1997.

# Introduction

The aim of the working paper is to compare competitiveness of the Czech Republic and Hungary. The whole concept of competitiveness is problematic, with no generally accepted definition (see Chapter 1). It can be seen from many different angles. The approach here is a comparison of the political, economic and legal environment, *i.e.* the institutions.[1] There can be doubts about the concept of competitiveness, but there are obvious differences in the institutional environment that affects market actors. The emphasis will be on the conditions providing the overall background for economic activity, which may be, but is not necessarily market-friendly. If it is not, there are additional costs for entrepreneurs, which affect their global ability to compete on international markets. The connection between the market environment of a country and its 'competitiveness' is only indirect. The environment determines the long-range ability of firms to compete and develop, but it does not have an immediate or straightforward impact on, say, the balance on the current account or the current rate of economic growth. The aim, however, is to give a global view of the environment and so of the potential for the economies and firms. There is a crucial problem with measuring the quality of the environment (see Chapter 2). The data obviously provide only a proxy measure and need to be taken accordingly.

The goal of the paper is reflected in its structure. Starting with the concept of competitiveness and the various approaches to it, the author puts forward and defends an approach to it1 that creates the basis for the rest of the paper. Chapter 1 contains some remarks on the methodology and starts to analyse the environment. I will decide for a few characteristics that I try to explore. The analysis will lead to conclusions. And I try to explain the results in the last chapter.

# 1) Defining competitiveness

The concept of the competitiveness on the level of states is questionable. There is no broadly acceptable definition. Some economists find competitiveness an important characteristic of economies and others regard it as a meaningless concept.

Among the first are the authors of the prestigious Global Competitiveness Report (hereafter GCR; Schwab and Sachs 2002) and the World Competitiveness Yearbook (hereafter WCY; IIMD 2001). They try to compile an index covering huge amounts of surveying and data to give an overall picture of the competitiveness of countries. Their approach is criticized, for example, by Lall (2001), but without questioning the idea of competitiveness as such. On the other hand, other economists deem the whole concept of competitiveness among states as meaningless (Kinkor 2001), arguing that only firms can compete, not states or economies. Most authors writing about competitiveness concentrate on the microeconomic level (*e.g.* European Commission 1999, Mytelka 1999, Fabella

[1] 'The rules of the game in a society' (North 1992).

1995, *etc.*) They use statistics such as productivity, wages and share of technological exports.

This author agrees with the assertion in Bannock, Baxter and Davis 2003 that the term is difficult to handle. The following definition of competitiveness appears: 'A loose term, popularly used to reflect the ability of a nation to grow successfully, and to maintain its share of world trade.'

This paper intends to sidestep that discussion. The author does not believe in competition at state or national-economy level, especially not in the form of an aggregated index. The concept in the GCR is very broad and there will always be discussion about the selection (and formulation) of the questions, the weightings and the conclusions. Although the author takes the view that only firms can compete on the internal or/and international markets. But the paper is not confined to the microeconomic level, either. First, it seems difficult to bring anything new into this field. Nor can the author agree with the purpose of most of these analyses, which seem usually to be targeted at 'improving the competitiveness of the country'. The conclusions of such reports then take the explicit or implicit form of advocating government help, investment or support for certain industries. These reports in fact indicate the eagerness of governments to pursue ad hoc (discretionary) industrial policies. It is questionable whether the state (or government) can steer industries to a higher level of technological exports. The attitudes to government abilities in this respect vary substantially, from strong trust in government (*e.g.* Lall 2001) to belief in its new role (*e.g.* Gál, Moldicz and Novák 2003) or total rejection (*e.g.* Kinkor 2001). The author does not share the belief that state functionaries have better information and motivation than the private sector and are able to direct industries (or the whole economy) by transferring resources from productive to less productive firms. On the other hand, most economists would agree on government answerability for the overall economic environment: the legal and political systems and global economic background. This always has an impact on the behaviour of market actors and so affects their ability to compete. This environment differs substantially between countries. To take the example of bankruptcy, it makes a huge difference whether the process takes six months or five years. Or consider state regulation. It is again essential whether a business can be started in three days, three weeks, three months or three years. The environment thus creates direct or indirect costs for firms. In fact, cross-country empirical studies identify a positive association between long-term GDP growth per capita and measures of institutional quality at the beginning of the period over which the growth rate is measured (Fries, Lysenko and Polanec 2003).

The institutional change is one of the most difficult steps in the transformation process. Institutions can be classed as formal or informal (Jonáš 1999). The first group consists (for example) of the legal environment – the whole legislative and judicial system. The second is more difficult to outline. It consists of habits in society, such as moral forms. Formal institutions are relatively easy to change, but the moral shifts of informal institutions take place over the long term. Government action can influence the development of formal institutions but informal institutions can only be influenced indirectly. But the transformation called for both to change. As the legal environment shifts towards the market economy, so the mood and morals of nations should shift in the same direction, for example towards self-responsibility and diligence. There are disputes about interpreting the importance of these institutional changes during the transformation process. The International Monetary Fund, for instance, opined that 'the importance of institutional reforms was recognized already in the beginning of the transition. In practice, however, too little attention was paid to it [*sic*], in contradiction to the macro economic development and that [inadequate attention applied] from the side of international consultants as well as from the side of domestic politicians' (IMF 2002).

The importance of the institutional environment is a subject of general debate (in developed as well as transition countries). Still more is the importance of individual aspects of the environment, which the present author considers to have a strong impact. Ill-functioning institutions in the economy impede firms in developing and competing in ways that appropriate institutions do not. Institutions in fact create a crucial background for all activities in the economy. The analysis in this paper focuses on the institutions under governmental control, where policy changes can be recommended. A government that creates a better institutional environment improves conditions equally for all market actors, not just preferred groups, and obviously enhances the ability of firms to compete.

The problem of competitiveness will therefore be considered in terms of direct and indirect costs imposed on firms by the economic environment. Since the overall problem is very extensive, just a few topics connected with the political, legal and economic environment will be treated, namely economic freedom, start-up costs and protraction of court proceedings. In other words, the treatment will not be comprehensive.

## 2) METHODOLOGY

It is hard to describe the overall environment and still harder to grade and compare it, but there are statistics to give a basic picture. It is not advisable, of course, to rely on a single source for a topic like the institutional environment, and even with multiple sources, it remains tricky to arrive at reasonable, defensible results. But if different sets of statistics yield similar results, that can be seen as a kind of evidence.

It has been decided in this paper to concentrate on a comparison of countries in the fields of political, economic, legal situation or institutional environment. The weak point already mentioned is measuring the quality of the economic environment, where data is always questionable. The problem can generally be dealt with on an overall level – there are organizations that evaluate countries in a specific field (political environment or economic freedom) and aggregated this into a global picture (*e.g.* an index of political or economic freedoms). These statistics are usually based on:

(a) Other statistics and surveys – polls of polls. An example is the Index of Economic Freedom (IEF) published by the Fraser Institute (Gwartney, Lawson and Emerick 2003).

(b) Expert evaluations, *e.g.* Nations in Transit (hereafter NiT; Freedom House 2002 and 2003b).

(c) A combination of (a) and (b), *e.g.* the Corruption Perception Index published by Transparency International (hereafter TI; see website).

Some statistics are more specific and the boundary does not have to be sharp. They deal with a single specific question or a bundle of them. Authors may or may not try to deduce global results, such as addressing whether 'administrative regulations in your country are 1 = burdensome, 7 = not burdensome', as does the GCR. These surveys may even try to deal with quantifiable questions, such how many days are needed to start a new business, which is estimated in the Doing Business survey published by the World Bank Group (hereafter DB; see website).

The first type of survey, dependent on other polls, can be criticized for the weightings they give to particular surveys, especially if there are connections between the sources and the final poll. The findings can similarly be questionable. The second type is vulnerable for concentrating on specific questions put mainly to firms or law firms, so that it is questionable whether global findings about the environment can result.

Other, general problems may arise with factors that impress experts or firms, such a general mood of optimism or pessimism. A good example is the state of the economy. All the problems that impact on firms will seem less painful in a period of growth than during a recession. There can be very similar effects on expert opinions, for example at time when everybody is writing about prevailing corruption in a country. Although experts try to be as much objective as possible, they can hardly avoid being influenced by general opinion or the views of others.

Additionally there can be general problems with the questions. The response to the question 'Administrative regulations in your country are 1 = burdensome, 7 = not burdensome' depends on the feelings of words and is highly subjective. An environment that Westerners would describe as burdensome may be sensed differently in a transition country. That poses problems with the canvassed views of foreigners as opposed to domestic respondents, with both exhibiting imperfections.

All the types of statistics mentioned have their drawbacks. It is tempting to concentrate on measurable questionnaires, but these are scarce and it is questionable whether overall conclusions can be drawn from them. The paper therefore aims to provide as comprehensive a picture through all available statistics, including some questions from the GCR, despite doubts about the overall strategy it employs. Both scores and placing of countries are given for all data sources, but with emphasis on the first. The analysis includes comparisons with other Central European countries – Poland, Slovakia and Slovenia – where helpful. The discussion of every topic begins with a description of the whole economic environment and then proceeds towards more specific questions, to yield as rounded a picture as possible. The intention is for the paper to arrive at the best combination of these approaches.

# 3) Analysis of the data

In analysing several characteristics of the overall environment, the paper dwells on the political, legal and overall economic environment, emphasizing some specific features.

## *3.1. The political environment*

The influence of political freedoms on the economy is questionable.[2] But it can be supposed that a stable political environment devoid of misuse of political power lessen risks and costs for firms. Political freedom is also part of the complex of the rule of law. Generally speaking, greater political freedom in a country increases the probability of finding a more accountable government and therefore less corruption, sounder economic policies and less governmental malpractice. Put another way, want of political freedom decreases or rules out the possibility that economic freedoms are being observed.[3]

This and the next two sections divide into two sub-sections, on global, overall reports and on specific issues.

[2] There are a few countries, such as China, where economic freedoms exist but political freedoms are not respected. The evolution of both types in the long term is questionable. Many experts suppose a shift towards political freedom. For the disputes on the impact of democracy on economic development, see Todaro and Smith 2003, for instance.

[3] This view is supported for example Freedom House 2003b, which finds a strong correlation between democratization and economic liberalization in countries.

### *Overall reports*

Freedom House, one of the most respected organizations dealing with political freedoms,[4] publishes an annual survey entitled Freedom in the World, offering two indices that evaluate political freedoms around the world. One is targeted at political rights – the ability of people to participate freely in the political process: the right to vote and run for public office and elect representatives with a decisive vote on public policies. The other index measures the prevailing level of civil liberties, including the freedom to develop opinions, institutions, and personal autonomy without interference from the state.

Both countries have scored similarly in both indices in the last decade and are deemed generally free; they have similar shortcomings in civil liberties (*Table 1*).

According to the survey, citizens of both countries generally enjoy all political rights. But there is criticism connected especially with discrimination against the Roma minority. There is in general no direct explanation of the scores.

The other survey by Freedom House (2003b) concentrates on the countries of the Central and Eastern Europe and provides somewhat deeper information on:

* The political process – national executive and legislative elections, development of the multi-party system, and popular participation in the political process. Civil society – growth of non-governmental organizations, organizational capacity and financial sustainability of these, and the legal and po-

[4] A non-profit, non-partisan body collecting data on political freedoms since 1955. See website.

litical environment in which they function.

* Media independence – the legal framework and present state of press freedom.
* Governance and public administration – the authority of legislative bodies, decentralization of power, the responsibilities, elections and running of local-government bodies, and legislative and executive transparency.

The scores for the two countries appear in *Table 2*.

The tables show that political freedoms are on similar levels in the two countries. Both show some decline in such freedoms at the end of 1990s, with the situation a little worse in the Czech Republic. The caveats were concentrated on the electoral process and development of civil society. However, governance recently worsened in Hungary. This report again offers no direct explanations, apart from a comment: 'The ratings and scores reflect the consensus of Freedom House, its academic advisors, and the author of this report.' The reports are otherwise descriptive – analysing political developments and the political situation without justifying specific scores. The reservations mentioned are similar to ones found in main report of the organization (Freedom House 2003a).

### *Specific reports*

There are all too few statistics of use for this paper, but some questions in the Global Competitiveness Report (hereafter GCR; Schwab, Porter and Sachs 2002) and WCY (IIMD 2001) seem interesting. According to the former, 'The data used in the Report represents the best available estimates from various national authorities, international agencies, and private sources at the time the Report was prepared (July/August 2001).' There are no indications as to how they arrive at specific data.[5] (*Table 3*)

The answers to the first two questions point to a stable political situation in both countries. The government generally keep the promises made by previous governments and political changes do not affect economic planning. But both countries display strong distrust to politicians, with a substantially worse situation in the Czech Republic.

A similar source is the WCY.[6] The surveys focus on the business impact, but some answers shed useful light on political development. (*Table 4*)

This survey shows that political risks and adaptability were understood to be relatively high, again with significantly better scores for Hungary.

## *3.2. The legal environment*

Another section of the global economic environment is the legal system, which can obstruct economic development and operation of firms. Firms are directly influenced by many aspects of the law.[7] Among the most vital, perhaps, are enforcement of contracts and security of private property. Additions or amendments to the legal system form a highly complicated long-term process. This was

[5] These notes apply to all quotations from the report.

[6] The survey, sent to top and middle management in 49 countries, was returned in 2001 by 3678 respondents. Each responded about the country in which they work, so that the results reflect in-depth knowledge of each economy (IIMD 2001).

[7] The legal system has crucial importance for economic development (see North 1992).

true especially in the transformation period, where the legal systems of transition countries had been deformed by the perceived needs of the communist party during the long period of totalitarian rule. Furthermore, all transition countries have had trouble law enforcement and the judiciary as well. Judges lacked basic knowledge of how a market economy functions and courts were unprepared for a surge of litigation.[8] It is very hard to measure the state and/or development of the legal environment. Let us concentrate first on estimates evaluating the systems as a whole, before targeting particular statistics. The final sub-section considers corruption, one of the essential aspects of the legal environment.

### *Overall reports*

One organization that has tried to grade the legal environment (in huge areas of the legal system) is the European Bank for Reconstruction and Development (EBRD). This publishes annual Transition Reports (EBRD 2000, 2001, 2002 and 2003). Up to 2002, two of the statistics included gave an overall picture of the legal environment in the transition economies, covering (i) commercial law – include pledge, bankruptcy and company law, and (ii) financial regulations – banking and capital-markets law.[9]

According to the EBRD the measures were developed to 'assess the extent to which key commercial and financial laws have reached internationally acceptable standards (extensiveness) and the degree to which are these law implemented and enforce (effectiveness)'. Developments of both are depicted in *Tables 5, 6 and 7.*

The situation in commercial law has been substantially better in Hungary than in the Czech Republic since 1999 – after the grades of the latter worsened. Hungary, on the other hand, had close to maximum scores from the beginning of publication of the annual report until a slight worsening after 1999. The situation of the Czech Republic improved to Hungarian levels in 2002.

The second indicator gives a different comparison. Financial regulations have been stable and of high quality in Hungary since 1998–2000. Then the situation seems to have worsened. On the other hand, the Czechs were lagging behind and slightly improving during the period. The situation in both countries in 2002 was comparable.

Another institution grading the global legal system is Freedom House.[10] The Index of Constitutional, Legislative, and Judicial Framework highlights constitutional reform, human-rights protection, criminal-code reform, the judiciary and judicial independence, and the status of ethnic minority rights.

The same patterns appear in the EBRD ratings. The numbers are relatively low, so that the situation in both countries should be regarded as relatively good over the whole period. But the environment in the Czech Republic has been significantly worse than in Hungary since 1999, with a sharp worsening of

[8] The overall support of judges for the new political and economic system is also questionable.

[9] The grading was derived from the views of local lawyers. The numbers seem to be the result of careful research (see Conditions, EBRD 2003).

[10] These grades are part of the NiT survey already quoted. It should be recalled that 'the ratings and scores reflect the consensus of Freedom House, its academic advisors, and the author of this report'. The report otherwise mentions only development and specific events in the year, so that the authors do not justify the individual grading.

the legal situation at that year. On the other hand, the ratings for Hungary were stable over the whole period.

*Specific reports*

Some organizations publish specific reports on a particular question or problems (usually as part of a larger task). One of the most interesting is the World Bank database DB,[11] several of whose findings are mentioned in the following pages. On the legal environment, an interesting part of their data is concerned with contract enforcement. The section of the survey compares four sets of information that can be extracted from the 'process of debt-recovery cases before local courts in the country's most populous city'.[12] The first of the indicators supplies the number of proceedings mandated by law or court regulation (demanding interaction between the parties or between them and the judge or court officer). The second indicator denotes the number of days (from the moment the plaintiff sued in court until the moment of actual payment). The third indicator depicts the cost of the whole proceedings (including court costs and attorneys' fees, as well as payments to other professionals such as accountants and bailiffs). Additionally, the study offers information about how complicated the whole proceedings are – the Procedural Complexity Index.[13] (*Table 8*)

[11] According to the World Bank: 'DB aims to provide a new set of objective, quantifiable measures of business regulations and their enforcement.' See website.

[12] Data on contract enforcement are derived from responses to questionnaires by lawyers in private practice.

[13] The index is calculated from six sub-indexes. See World Bank website.

This survey finds advantages and drawbacks in the systems for enforcing contracts in both countries. In the Czech Republic, the duration and number of the steps are lower, but the system is more complicated and more expensive to deal with. In Hungary, the system is less expensive and less complicated, but substantially longer. By comparison with the average for high-income OECD countries, cases take longer and dealing are more complicated in both countries.

The same survey offers data about winding up a business that says a lot about the functioning of the legal system and ability of market actors to recover credit extended. The authors concentrate on four characteristics of the cases, which are carefully specified in detail (see World Bank group website):

* The time needed to complete a procedure, as estimated by insolvency lawyers.
* The actual costs associated with completing insolvency proceedings in court.
* The Goals-of-Insolvency Index, which gives an overall view of the insolvency system (100 is the most efficient).
* The Court-Powers Index, which measures the degree to which the court runs insolvency proceedings through an average of three indicators: whether the court appoints and replaces the insolvency administrator without restrictions imposed by law, whether the reports of the administrator are accessible only to the court, not to creditors, and whether the court decides on adoption of the rehabilitation plan. The index is scaled from 0–100, with higher values indicating greater court involvement.

The results are not encouraging for either country, but the Czech case is worse than the Hungarian. The duration of insolvency proceedings is remarkable and amounts to an inability to assert property rights in case of insolvency. Costs are the same in both countries and high by comparison with a high-income OECD country. It is similar with the rest of indicators, which are notably worse in the Czech Republic. (*Table 9*)

The last *Transition Report* (EBRD, 2003) published statistics on secured transactions, based on a 34-point questionnaire put to a sample of lawyers. The time required, the amount of secured property and the simplicity of the process were evaluated.

Hungary was classed in a group with Lithuania and Slovakia labelled 'advanced reform countries' and the Czech Republic in second group of 'major reform countries'. It can be seen that Hungary has no trouble with the 'process' part, and even in the 'scope' part, its results are much better than the Czech Republic's. (*Table 10*)

Another to some extent specific index is offered by other survey by the EBRD – the Business Environment and Enterprise Performance Survey (Fries, Lysenko and Polanec 2003).[14] These surveys involved on questioning 6153 firms in 26 countries of the region in 1999 and 4041 firms in 25 countries in 1999. The authors took a similar approach to the researchers in the World Bank group. They too concentrated on the average amount of time needed to resolve an overdue payment. In their case, the measure reflects the time spent pursuing a claim through the courts and through alternative collection procedures. The authors asked respondents how long on average it took to collect overdue payments and how frequently firms paid bribes in their dealings with the courts. Several questions were aimed at gathering information on confidence in the courts.

These together created a Judiciary Index,[15] in which the Czech Republic and Hungary achieved the scores in *Table 11*. The results seem to augment the previous survey. The situation in Hungary in both years was likewise significantly better than in the Czech Republic, but the figures point to an improvement in both economies after 1999, with Hungary approaching the ideal.

Use can also be made of the GCR (Schwab, Porter and Sachs 2002) to address specific questions to do with the legal environment (*Table 12)*.

The first two questions seem to support the belief that neither country has an optimal judicial environment. But as in the previous surveys, the Czech Republic emerges as much worse. The responses to the second question seem to confirm the problems with property rights mentioned in connection with the World Bank group. The third question was already mentioned when describing the political environment. From point of view of costs, legal changes in recent years have not affected firms seriously in either country.

Similar surveys appear in the WCY (*Table 13*).

[14] An initiative of the European Bank for Reconstruction and Development (EBRD) and the World Bank to investigate the extent to which government policies and practices facilitate or impede business activity and investment in Central and Eastern Europe and the Commonwealth of the Independent States.

[15] No specific information on weightings is given in the survey report.

These answers all support the idea that the legal environment is better in Hungary than in the Czech Republic. The Hungarian situation is relatively good – all the fingers are higher than the median 5. On the other hand the Czech results are all below the mean and substantially worse than the Hungarian ones.

## 3.3. Corruption

Corruption is a characteristic of the legal environment. It is difficult to spot as it appears in many different forms. Corruption increases transaction costs and risks, and decreases the credibility of a country and the trust of market agents. So there is direct impact on the ability of firms to compete on international markets. Economists suspect a negative correlation between prevailing level of corruption and foreign direct investment. There are obvious problems with measuring corruption and comparing it internationally.

The leading supplier of international data on corruption nowadays is Transparency International (TI),[16] which publishes an annual survey: the TI Corruption Perception Index. This is highly popular with all parties concerned with corruption (pressures groups, government or ordinary people) and is often quoted. The index is actually a poll of polls. Among the sources for 2003 are the GCR (some specific questions), the WCY, the World Business Environmental Survey, the Freedom House NiT report and several similar studies, including one by Gallup International for the TI.[17] The index is constructed as a simple average of standardized data from the surveys. In the opinion of the TI, it reflects 'the perceptions of business people, academics and risk analysts, both resident and non-resident' (TI website). Perceptions are graded 0–10, with a higher number as less corruption and 10 as a corruption-free environment (*Table 14*).

The development seems to indicate clearly worsening corruption in the Czech Republic in the second half of the 1990s, as opposed to a relatively stable situation in Hungary. The two countries were in similar positions in 1996, but the Czech Republic has become noticeably the worse since then. Even Hungary did not achieve in 2003 half the point score of the best country. The high and low range in 2003 was 4–5.6 for Hungary and 2.6–5.6 for the Czech Republic.

Another source of information about corruption is NiT from Freedom House, mentioned earlier. The results appear in *Table 15*. The corruption index looks at 'perceptions of corruption in the civil service, the business interest of top policy-makers, laws on financial disclosure and conflict of interest, and anti-corruption initiatives'. The report includes the comment that 'the ratings and scores reflect the consensus of Freedom House, its academic advisors, and the author of this report.'

These results seem to support the view of TI. The corruption environment seems to be strong in both countries, but significantly worse in the Czech Republic. However, the findings should be interpreted with caution. According to short comments in the report, an impor-

[16] TI, according to its website, is 'the only international non-governmental organization devoted to combating corruption, brings civil society, business, and governments together in a powerful global coalition'. See website.

[17] The number of surveys included varied significantly over the period. See Table 14.

tant source of information was the TI Corruption Perception Index. On the other hand, Freedom House 2003b quotes the TI Corruption Perception Index 2003 as a source. So there is some interconnection between the two, which may make the overall results misleading.

Some additional responses on corruption appear in the WCY (*Tables 16*). This survey supplements the previous. The situation in the public sphere is not optimal in either country, but in the Czech Republic, it is substantially worse.

As in the previous part, some of the GCR can be used to shed light on questions connected with corruption (*Table 17*).

The first four questions describe the environment through what managers think of the situation in their industries. The results are not encouraging, especially not for the Czech Republic, which is always below the mean and worse than Hungary. The Hungarian situation seems significantly better, with results usually above the mean and so in a better international position as well. The last question, about costs of other firms misbehaving, may be surprising. While Hungary's position is similar (or slightly better) than for the previous questions, that of the Czech Republic is significantly better.

Another index of corruption is part of the EBRD Business Environment and Enterprise Performance Survey mentioned earlier (Fries, Lysenko and Polanec 2003). The findings are based on questioning entrepreneurs. It is obvious that corruption is not only a problem for the business sector, but a survey focusing on firms should give another view of the problem. At the centre of the corruption part of the study is a so-called 'bribe tax', defined as 'unofficial payments to public officials'.

The results are again surprising in comparison with the prevailing feeling of previous reports. The trend in both countries should be substantially improving – fewer companies admit offering bribes. Another surprise may be the position of Czech firms compared with Hungarian – in 1999, fewer of them offered albeit larger bribes. The situation developed further up to 2002, with the proportion of firms offering bribes halved and the yield of the 'tax' also declining sharply. (*Table 18*)

## *3.4. The economic environment*

The last part of the analysis concerns the economic environment as a whole, especially economic freedom. It is another large and diverse field, covering government regulation, interference in prices, labour-market intervention, trade protectionism and similar activity. The impact on competitiveness is direct. If firms are less free, they have higher costs that make them less competitive. Some authors (*e.g.* Gwartney, Lawson and Emerick 2003) posit a strong correlation between economic freedom and per-capita income, economic growth and life expectancy.[18]

There are again different ways of approaching the subject. Some organizations publish reports of economic freedoms that try to aggregate surveys into an index intended to describe the overall economic environment. These have some

[18] On the impact of the regulations on the economic environment, see Pejovic 1998.

value and are quoted in the first section. The second concentrates on specific characteristics connected with state regulation, such as how long it takes to start a business or the time spent dealing with state officials.[19]

## *Overall reports*

Two organizations issue reports of economic freedom on a global level: the Heritage Foundation and the Fraser Institute.

The former publishes an annual Index of Economic Freedom, which its authors define as measuring 'the absence of government coercion or constraint on the production, distribution, or consumption of good and services beyond the extent necessary for citizens to protect and maintain liberty itself.' Ten categories (see below) are included and weighted equally.[20] The findings for both countries appear in *Chart 1*.

The two countries are in roughly similar positions, according to the index, with the Czech Republic seen as a little freer throughout the period. In addition to the overall score (and to give picture of how it was arrived at), the authors publish a summary briefly describing the countries' background.[21] These numbers are interesting enough to consider all the values for the last year, but it was decided to concentrate on the field of government regulation in this paper. (*Table 19*)

The main category here is 'regulation', which covers, for example:

* Licensing requirements to operate a business.
* Ease of obtaining a business licence.
* Corruption within the bureaucracy.
* Labour regulations.
* Regulations that impose a burden on business.

Both Central European countries score 3 in this field, which means 'moderate' regulation and corresponds specifically to 'complicated licensing procedures; regulation imposes substantial burdens on business; and similar.' So the regulation burden is relatively high in both countries. In Hungary, the authors write, the regime meets EU standards, but the regulations are not always transparent or evenly applied. In the Czech Republic, they mention bureaucratic corruption as big problem, quoting foreign analyses. There are detailed figures on this in the next sub-section.

The second of the global indexes is published by the Fraser Institute (Gwartney, Lawson and Emerick 2003).[22] The latest report – *Economic Freedom of the World 2003 Annual Report* – contains 38 variables and the findings of 18 surveys. The report, according to its authors, is based on variables obtained from survey data published in the International Country Risk Guide and the GCR.

We will proceed the similar way as in the previous case. We will show the overall picture that the Index offers and then we concentrate our interest on – about state regulations. (*Table 20*)

[19] The author chose this field as one connected closely with the previous chapters of the paper.

[20] The scores in each category are based on other surveys. For a detailed description, see Heritage Foundation 2004. The data cover the second half of 2002 to the first half of 2003.

[21] There is a two-page description for each country and short notes on every field.

[22] The Fraser Institute is an independent Canadian economic and social research and educational organization. See website.

The overall pictures for both countries improved over time, so that their scores and placings increased and remained roughly similar. The leader in the last report was Hong Kong with an overall score of 8.6. The average score in 2001 was 6.35.

The situation was different in the area of special interest for this paper. Regulation of businesses increased in 2001 and was worse in both countries than in 1995. Otherwise, the situation was better in Hungary than in the Czech Republic. The rating was especially weak in administrative obstacles for new business, which were high in Hungary and even higher in the Czech Republic. In other respects, some of the data seem questionable, for example, the sharp worsening of the index for price controls in Hungary last year and the strange jumps in the same indicator for the Czech Republic in previous years.

### *Specific reports*

Specific data on government regulation of the economic environment appears, for instance, in the World Bank group survey DB (World Bank group website). One set of data concentrates on operations to do with starting a new business (*Table 21*).

The results for both countries were worse than the OECD average,. Hungary had a below-average number of procedures, but called for more capital and twice as much time for starting a business. Though start-up costs were markedly lower in the Czech Republic than in Hungary, they were much higher than in the average OECD country, while the whole process was time-consuming and complicated.

The second source is again the GCR (Schwab, Porter and Sachs 2002, *Table 22*). This needs careful interpreting due to cross-linking with other statistics.

The survey gives different figures from the previous, but the outcome is similar – start-ups are harder in the Czech Republic and take significantly more time despite fewer processes. Both countries have relatively low red-tape indicators, and both countries do well (relative to other countries) in the overall perception of regulation (6.08), although the actual scores are low, which means firms feel the burden is intense.

The last of the surveys to be noted is the WCY (IIMD 2001, *Table 23*). The results seem worse than the previous. The bureaucracy burden is high in both countries, but the Czech situation is significantly worse.

## 4) CONCLUSIONS

It is time to aggregate the data, draw conclusions in each field, and seek explanations.

Political rights are generally observed in the Czech Republic and in Hungary. The specific surveys support the impressions gained from the overall statistics. This conclusion is unsurprising insofar as democracy is a requirement for EU entry. The surveys notice few reservations that would not remain an obstacle to economic development even if they improved. The two countries are in very similar positions in relation to comparable (minor) criticisms.

The two legal systems are more interesting to compare. The situation is not ideal in either country, but substantially worse in the Czech Republic. This conclusion is supported by both overall and specific reports. In the specific case of corruption, the overall statistic from TI and most of the specific surveys support the notion that corruption in both countries is high and the situation stagnant if not worsening. It is worse in the Czech Republic. But there are interesting exceptions. The EBRD report on the business environment gives opposite results. It would be surprising if corruption overall were worsening in both countries (TI) but firms were paying substantially fewer bribes. The explanation for the difference in the findings could lie in the phrasing of the question. In the EBRD survey, it was directed at specific behaviour by firms, not at overall feelings or opinions about other actors' behaviour. At least in the Czech Republic, a self-critical attitude (especially towards corruption) is very popular, so that the general level may be exaggerated in the survey. This analysis gains further support from another direct question – 7.06 in of the GCR – where the effect on firms of other firms' misbehaviour is surprisingly low compared with the allegedly predominant level of corruption in both countries. This again is a specific answer to a direct question, about how a particular actor is affected, not a global, vague question about prevalent corruption. So it does seem that the difference is in the formulation – of asking about what actors do or do not do, rather than what they suppose. But there are too few specific surveys available to prove this hypothesis. On the other hand, the situation in both countries is obviously imperfect and far from being corruption-free countries like New Zealand or Denmark. Governments need to try to improve the environment and prevent such misbehaviour.

With economic freedom, the overall figures are slightly better for the Czech Republic, but in areas of specific interest for this paper, the situation in Hungary is generally better (even where the statistics are less ambiguous, as with the legal environment).

An additional attribute that emerges in several surveys (TI, Freedom House and EBRD), is that the Hungarian situation is usually stable, with relatively small shifts up or down over the whole period studied. In the Czech Republic, there seem to have been dramatic changes. It is hard to imagine that the effectiveness of the legal environment for business should suddenly have worsened in a single year (1999), as the EBRD Transition Report 2000 suggests. The same appears to have happened with the overall legal environment, according to the NiT report of Freedom House (1.5 to 2.25) – again in 1999. And even corruption should dramatically worsen according to TI (even if not in one year) from 5.2 in 1997 to 4.2 in 2002. It seems that these indexes were affected by other factors. In my point of view the main cause is disillusionment with the state of the Czech Republic following the currency crisis (1997) and subsequent recession. Before 1997, the country was a favourite with domestic and foreign experts. Everything changed with the recession and situation began to be seen in gloomier colours. The question is whether the earlier figures were wrong and the present ones are correct, or vice versa. Unfortunately, the discrepancies cast doubt on the figures, in the author's view.

Another problem that arose in the research was interconnection between the statistics. The TI Perception Index and the NiT survey, for instance, seem to be tightly bound up, which leaves overall results questionable.

Regardless of these doubts, it seems at least that the legal system in Hungary is substantially better than in the Czech Republic. The Czechs should work on improving their legal environment, especially in protecting property rights. This is a crucial step towards improving the global abilities of entrepreneurs. There can be many different explanations for the difference, such as the weakness of all Czech governments since 1996, but the author finds the roots go deeper. Changing the legal environment is long-term concern and initial conditions matter. In its legal system, Hungary was in a substantially better initial position than Czechoslovakia. *Table 24* demonstrates the obvious differences among countries in legislative fields and the whole business environment.

Similar excuses can be hardly given in state regulation, which is relatively easy to change. It should not be difficult, for example, to decrease the time required to start a new business. The governments of both countries need to simplify bureaucracy, clarify claims and decrease the time needed to deal with state administrators.

* * * * *

Table 1
Status, political rights and civil liberties in Hungary and the Czech Republic, 1993–2003

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Hungary | Free | Free | Free | Free | Free | Free | Free | Free | Free | Free | Free |
| Political rights | 2 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Civil liberties | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Czech Republic | - | Free | Free | Free | Free | Free | Free | Free | Free | Free | Free |
| Political rights | - | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Civil liberties | - | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |

*Source:* Freedom House 2003a.
Political rights – 1: close to ideal… 7: political rights absent; civil liberties – 1: close to ideal; 2: deficiencies in 3–4 aspects, but still relatively free… 7: virtually no freedom.

Table 2
Components and overall grading of democratization in the Czech Republic and Hungary, 1997–2003

| Czech Republic | 1997 | 1998 | 1999 | 2001* | 2002 | 2003 |
|---|---|---|---|---|---|---|
| Electoral process | 1.25 | 1.25 | 1.75 | 1.75 | 2.00 | 2.00 |
| Civil society | 1.50 | 1.50 | 1.50 | 1.50 | 1.75 | 1.50 |
| Independent media | 1.25 | 1.25 | 1.75 | 2.00 | 2.50 | 2.25 |
| Governance | 2.00 | 2.00 | 2.00 | 2.00 | 2.25 | 2.25 |
| *Democratization scores* | *1.50* | *1.50* | *1.75* | *1.81* | *2.13* | *2.00* |

| Hungary | 1997 | 1998 | 1999 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|
| Electoral process | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 |
| Civil society | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 |
| Independent media | 1.50 | 1.50 | 2.00 | 2.25 | 2.25 | 2.25 |
| Governance | 1.75 | 1.75 | 2.50 | 3.00 | 3.00 | 2.50 |
| *Democratization scores* | *1.50* | *1.50* | *1.75* | *1.94* | *1.94* | *1.81* |

*Source:* Freedom House 2003b.
* There are no data for 2000 in the source.
Scores are on a scale of 1–7, with 1 as the highest and 7 as the lowest level.

Table 3
Statistics describing the political environment in 2001 – scores and placings

| | Czech Republic | Hungary | Poland | Slovenia | Slovakia | Leader | Mean |
|---|---|---|---|---|---|---|---|
| 6.05 Government commitments – new governments honour contractual commitments and obligations of previous regimes: 1 = not true, 7 = true. | 5.1 (31) | 4.2 (48) | 5.2 (27) | 4 (55) | 4.5 (45) | Switzerland (6.7) | 4.8 |
| 6.07 Cost of institutional change – legal or political changes over past five years have 1 = severely undermined your firm's planning capacity, 7 = had no effect. | 5.2 (18) | 4.9 (28) | 4.9 (29) | 3.4 (63) | 5.1 (25) | Finland (6.6) | 4.5 |
| 7.07 Public trust of politicians – public trust in the honesty of politicians is 1 = very low, 7 = very high. | 1.9 (58) | 2.6 (41) | 2.4 (45) | 2.8 (36) | 3.0 (32) | Singapore (6.4) | 2.9 |

*Source:* Schwab, Porter and Sachs, 2002.

Table 4
Statistics describing the political situation, 2001

| | Czech Republic | Hungary | Poland | Slovenia | Slovakia | Leader |
|---|---|---|---|---|---|---|
| 2.3.12 Political system – 0 = not well adapted to today's economic challenges, 10 = well adapted. | 4.185 (29) | 5.273 (16) | 3.538 (36) | 3.692 (35) | 3.886 (33) | Singapore (7.761) |
| 2.3.20 Risk of political instability – 0 = very high, 10 = very low | 6.264 (31) | 7.818 (22) | 4.594 (41) | 5.231 (37) | 6.543 (27) | Luxembourg (9.895) |

*Source:* IIMD 2001.

Table 5
Indicator for commercial law in the transitional countries, 1997–2002

| | 2002 | | | 2001 | | | 2000 | | | 1999 | | | 1998 | | | 1997* | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness |
| Czech Republic | 4- | 4- | 4- | 3 | 3 | 3 | 3+ | 3 | 3+ | 3 | 3+ | 3- | 4 | 4 | 4 | 4 | 4 | 4 |
| Hungary | 4- | 4- | 4- | 4- | 4- | 4- | 4- | 4 | 4- | 4- | 4 | 4- | 4 | 4 | 4 | 4 | 4 | 4 |
| Poland | 3+ | 3+ | 4- | 3+ | 4- | 3 | 4- | 4- | 4 | 3+ | 4 | 3 | 4 | 4 | 4 | 4 | 4+ | 4 |
| Slovakia | 3+ | 3 | 3+ | 3+ | 3+ | 3+ | 3 | 3 | 3 | 3 | 3+ | 3 | 2 | 3 | 2 | 3 | 3 | 3 |
| Slovenia | 3+ | 3+ | 4- | 4- | 4- | 4 | 4- | 4 | 4- | 4 | 4 | 4 | 3 | 3 | 3 | 3 | 4 | 3 |

*Source:* Transition report 2002, 2000
* The indicator was first published for 1997.
Extensiveness:
3 New or amended legislation has recently been enacted in at least two of the three areas on which this paper focuses – pledge, bankruptcy and common law – but could benefit from further refinement and clarification. Legal rules permit a non-possessory pledge over most types of movable assets.
4 Comprehensive legislation exists in at least two of the three areas on which this paper focuses.
4+ Comprehensive legislation exists in all three areas of commercial law on which this paper focuses. Legal rules closely approximate to those of developed countries.
Effectiveness:
3 Commercial law is reasonably clear; administration of justice is often inadequate or inconsistent, creating a degree of uncertainty.
4 Commercial law is reasonably clear; administration of justice is reasonably adequate.
4+ Commercial law is clear and readily ascertainable, and well supported administratively and judicially, particularly efficient functioning of the courts, liquidation proceedings, orderly and timely registration of shares, and orderly and timely registration of security interests.
Overall score – average of the two indicators.

Table 6
Legal transition indicator: financial regulation – banking and financial institutional law and regulation of capital markets

| | 2002 | | | 2001 | | | 2000 | | | 1999 | | | 1998 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness | Overall | Extensiveness | Effectiveness |
| Czech Republic | 3 | 3+ | 3 | 3+ | 3+ | 3 | 3+ | 4 | 3- | 3 | 3+ | 2+ | 3 | 3+ | 3- |
| Hungary | 3+ | 3+ | 4- | 4- | 4- | 4- | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Poland | 3+ | 4- | 3+ | 3+ | 4 | 3 | 4 | 4 | 4 | 4 | 4 | 4 | 4- | 4 | 3 |
| Slovakia | 3- | 3 | 2+ | 3 | 3 | 3 | 3 | 3 | 3- | 3+ | 4 | 3+ | 3- | 3 | 2 |
| Slovenia | 3 | 3+ | 3 | 4- | 4 | 4- | 4 | 4 | 4 | 3+ | 3+ | 3+ | 3 | 3+ | 3- |

*Source:* EBRD: Transition report 2002

Extensiveness: whether legal rules for banking and capital markets approach minimum international standards, such as the Core Principles of the Basle Committee on Banking Supervision. Effectiveness of legal reform measures: the extent to which legal rules for commerce and finance are clear, accessible and adequately implemented, administratively and judicially.

Extensiveness

3 Legislation for financial markets is perceived as reasonably comprehensive but could benefit from refinement in some areas. Banking rules appear generally to conform to the Basle Committee's Core Principles, although rules on bank insolvency and deposit protection may not have been adopted.

4 Comprehensive financial-market legislation is perceived as conforming generally to minimum international standards. However, refinement appears to be needed in at least one important area of either banking or securities regulation.

4+ Banking and capital-market legislation and regulation are perceived as comprehensive and in conformity with minimum international standards.

Effectiveness

2 Legal rules are perceived as somewhat unclear and sometimes contradictory. Supervision of financial institutions appears to exist only on an ad hoc basis.

3 Although legal rules on financial markets are perceived as reasonably clear, regulatory and supervisory support may be inconsistent, creating a degree of uncertainty.

4 Legal rules on financial markets are perceived as readily ascertainable. Banking and securities laws seem well-supported administratively and judicially, particularly regarding efficient enforcement measures against failing institutions and illegal market practices.

4+ Regulators appear to possess comprehensive enforcement powers and exercise authority to take corrective action on a regular basis.

Overall score – average of the two indicators, rounded down.

Table 7
The constitutional, legislative and judicial framework in the Czech Republic and Hungary, 1997–2003

| | 1997 | 1998 | 1999 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|
| Czech Republic | 1.50 | 1.50 | 2.25 | 2.50 | 2.50 | 2.50 |
| Hungary | 1.75 | 1.75 | 1.75 | 2.00 | 2.00 | 1.75 |

*Source:* Freedom House 2003.

Ratings based on a scale of 1–7, with 1 the highest and 7 the lowest level.

Table 8
Enforcing contracts in January 2003

| Region or Economy | Number of procedures | Duration (days) | Cost (% GNI per capita) | Procedural Complexity Index* |
|---|---|---|---|---|
| Czech Republic | 16 | 270 | 18.5 | 65 |
| Hungary | 17 | 365 | 5.4 | 57 |
| Poland | 18 | 1000 | 11.2 | 65 |
| Slovak Republic | 26 | 420 | 13.3 | 40 |
| Slovenia | 22 | 1003 | 3.6 | 65 |
| Europe & Central Asia | 25 | 344 | 27.9 | 56 |
| OECD high-income | 17 | 233 | 7.1 | 49 |

*Source:* The World Bank group website.
* Ranging from 0–100, with higher values indicating greater procedural complexity in enforcing a contract.

Table 9
Winding up a business in January 2003

| | Actual time (years) | Actual cost (% of assets) | Goals-of-Insolvency Index | Court-Powers Index |
|---|---|---|---|---|
| Czech Republic | 9.2 | 38 | 22 | 0 |
| Hungary | 2.0 | 38 | 38 | 33 |
| Poland | 1.5 | 18 | 70 | 67 |
| Slovak Republic | 4.8 | 18 | 71 | 67 |
| Slovenia | 3.7 | 18 | 41 | 67 |
| Europe & Central Asia | 3.2 | 15 | 51 | 57 |
| OECD high-income | 1.8 | 7 | 77 | 36 |

*Source:* World Bank group website.

Table 10
Qualifying factors in the enforcement process by the EBRD

| | Process | | | | | | Scope | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Debtor obstruction | Preferential creditors | Creditors control | Practical experience | Corruption* | Institutions | Scope of collateral | Insolvency procedure | Insolvency ranking | Inventory | Immovables | Receivables |
| Czech Republic | 1 | 1 | 3 | 2 | 1 | 1 | 3 | 3 | 3 | 3 | 2 | 1 |
| Hungary | 1 | 2 | 1 | 2 | 1 | 1 | 1 | 3 | 3 | 1 | 1 | 1 |
| Poland | 3 | 2 | 3 | 2 | 1 | 3 | 1 | 1 | 1 | 1 | 2 | 1 |
| Slovak Republic | 2 | 1 | 1 | 3 | 1 | 2 | 1 | 3 | 3 | 1 | 1 | 1 |
| Slovenia | 3 | 3 | 1 | 2 | 1 | 3 | 3 | 2 | 3 | 2 | 3 | 2 |

*Source:* The EBRD: Transition report 2003
Scores: 1–3; 1 – no significant problems or limitations; 2 – relatively minor problems or limitations; 3 – major problems or limitations.
* Although assessment was based on respondents' replies, reference was also made to the EBRD–BEEPS and Transparency International Corruption Perception Index.
Debtor obstruction: chances for a debtor to prevent, impede or otherwise obstruct enforcement.
Preferential creditors: impact of other creditors' claims on satisfaction of a secured creditor's claim.
Creditor control: ability of a creditor to control or influence the conduct of the enforcement process.
Practical experience: general level of experience with the enforcement process in the country.
Corruption: impact on the enforcement process of corruption within the judicial system.
Institutions: reliability of the courts and other institutions necessary to the enforcement process.
Scope of collateral: chance of enforcing replacement assets and subsequently acquired assets included in the general description of the collateral.
Insolvency procedures: impact of the debtor's insolvency on the enforcement process.
Insolvency ranking: priority of a secured creditor's claim upon an insolvent debtor.
Inventory: assessment of the simplicity and certainty of the enforcement process for a charge on inventory.
Immovables: simplicity and certainty of the enforcement process for a charge on immovables.
Receivables: simplicity and certainty of the enforcement process for a charge on receivables.

Table 11
Average scores in the Judiciary Index in 1999 and 2002*

| | 1999 | 2002 |
|---|---|---|
| Czech Republic | 2.48 | 1.91 |
| Hungary | 1.96 | 1.51 |
| Poland | 2.35 | 2.47 |
| Slovakia | 2.26 | 2.50 |
| Slovenia | 2.29 | 2.02 |

*Source:* Fries, S., T. Lysenko and S. Polanec (2003).
* 1 – best case; 4 – worse case.

Table 12
Statistics describing the legal environment – scores and placings

| | Czech Republic | Hungary | Poland | Slovakia | Slovenia | Leader | Mean |
|---|---|---|---|---|---|---|---|
| 6.01 Judicial independence – judiciary independent and not subject to interference by government and/or parties to disputes (1 = not true, 7 = true). | 4.0 (44) | 5.3 (24) | 5.0 (32) | 4.0 (45) | 4.4 (38) | Germany (6.7) | 4.4 |
| 6.02 Property rights – financial assets and wealth are 1 = poorly delineated and protected by law, 7 = clearly delineated and protected. | 4.4 (50) | 5.3 (32) | 4.6 (47) | 5.2 (34) | 4.8 (43) | Iceland (6.6) | 5 |
| 6.07 Cost of institutional change – legal or political changes over past five years have 1 = severely undermined your firm's planning capacity, 7 = had no effect | 5.2 (18) | 4.9 (28) | 4.9 (29) | 3.4 (63) | 5.1 (25) | Finland (6.6) | 4.5 |

*Source:* Schwab, Porter and Sachs 2002.

Table 13
The legal environment

| | Czech Republic | Hungary | Poland | Slovakia | Slovenia | Leader |
|---|---|---|---|---|---|---|
| 2.3.09 – Legislative activity of parliament (0 = does not meet, 10 = meets competitive requirements of the economy). | 4.528 (24) | 5.879 (10) | 4.159 (28) | 4.769 (20) | 4.000 (32) | Singapore (8.060) |
| 2.3.18 Justice (0 = is not, 10 = is fairly administrative in society). | 3.66 (36) | 5.58 (25) | 2.84 43) | 3.08 (42) | 4.77 (31) | Austria (9.04) |
| 2.3.19 Personal security and private property (0 = are not, 10=are adequately protected). | 4.87 (38) | 6.00 (27) | 2.75 (44) | 4.92 (37) | 5.66 (30) | Austria (9.44) |
| 2.4.07 Legal framework (0 = is detrimental, 10 = is not detrimental to country's competitiveness). | 4.906 (37) | 6.375 (22) | 5.191 (33) | 4.167 (41) | 4.943 (36) | Australia (8.429) |
| 2.4.14 Legal regulation of financial institutions (0 = is inadequate, 10 = is adequate for financial stability). | 4.717 (43) | 6.438 (30) | 5.172 (38) | 5.692 (35) | 4.667 (44) | Finland (8.600) |

*Source:* IIMD 2001.

Table 14
Perceptions of corruption, 1995–2003, scores and placings

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|---|---|---|
| Czech Republic | N/A. | 5.37 (25) | 5.20 (27) | 4.8 (37) | 4.6 (39) | 4.2 (43) | 3.9 (47) | 3.7 (52) | 3.9 (54) |
| Hungary | 4.12 (28) | 4.86 (31) | 5.18 (28) | 5 (33) | 5.2 (31) | 5.2 (32) | 5.3 (31) | 4.9 (33) | 4.8 (40) |
| Best | New Zealand (9.55) | New Zealand (9.43) | Denmark (9.94) | Denmark (10) | Denmark (10) | Finland (10) | Finland (9.9) | Finland (9.7) | Finland (9.7) |
| No. of countries | 41 | 54 | 52 | 85 | 99 | 90 | 91 | 102 | 133 |
| No. of surveys* | 7 | 10 | 7 | 12 | 17 | 16 | 14 | 15 | 17 |

*Sources:* TI website.
* The maximum of surveys used in a given year. The figures for Hungary and the Czech Republic were around two-thirds of these figures.

Table 15
Corruption index, 1999–2003

| | 1999 | 2001 | 2002 | 2003 |
|---|---|---|---|---|
| Czech Republic | 3.25 | 3.75 | 3.75 | 3.50 |
| Hungary | 2.50 | 3.00 | 3.00 | 2.75 |

*Source:* Freedom House 2003b.
The ratings are based on a scale of 1–7, with 1 representing the lowest level of corruption.

Table 16
Corruption indicators, scores and placings

| | Czech Republic | Hungary | Poland | Slovakia | Slovenia | Leader |
|---|---|---|---|---|---|---|
| 2.3.14 Public service 0 = is exposed to, 10 = is immune to political interference. | 2.566 (35) | 2.727 (32) | 2.636 (33) | 2.923 (30) | 2.429 (38) | Finland (6.050) |
| 2.3.16 Bribing and corruption 0 = exist, 10 = do not exist in the public sphere. | 2.340 (36) | 2.485 (35) | 1.363 (44) | 1.846 (39) | 2.771 (31) | Finland (9.525) |

*Source:* IIMD 2001.

Table 17
Statistics describing the corruption environment, scores and placings

| | Czech Republic | Hungary | Poland | Slovakia | Slovenia | Leader | Mean |
|---|---|---|---|---|---|---|---|
| 6.04 Favouritism in decisions of government officials – when deciding policies and contracts, government officials 1 = usually favour well-connected firms and individuals, 7 = are neutral among firms and individuals. | 3 (48) | 3.2 (43) | 3.1 (44) | 3.2 (42) | 3.5 (32) | Finland (5.7) | 3.4 |
| 7.02 Irregular payments in government procurement – how commonly do firms in your industry give irregular payments or bribes when getting connected to public utilities? 1 = common, 7 = never. | 4.5 (57) | 5.8 (27) | 4.7 (55) | 5.0 (43) | 5.3 (35) | Iceland (6.9) | 5.2 |
| 7.03 Irregular payments in tax collection – how commonly do firms in your industry give irregular extra payments or bribes connected with annual tax payments 1=common, 7=never | 4.3 (51) | 5.7 (26) | 4.7 (45) | 5.0 (38) | 5.2 (32) | Iceland (7) | 5.0 |
| 7.04 Irregular payments in public contracts – how commonly do firms in your industry give irregular extra payments or bribes connected with public contracts/investment projects? 1=common, 7=never | 3.1 (66) | 4.8 (28) | 3.6 (54) | 4.0 (43) | 4.1 (41) | Iceland (7) | 4.4 |
| 7.06 Business costs of corruption – do unfair corrupt activities of other firms impose costs on your firm? 1=impose large costs, 7=impose no costs | 5.1 (28) | 5.3 (23) | 4.9 (32) | 5.0 (29) | 4.8 (35) | Iceland (6.9) | 4.7 |

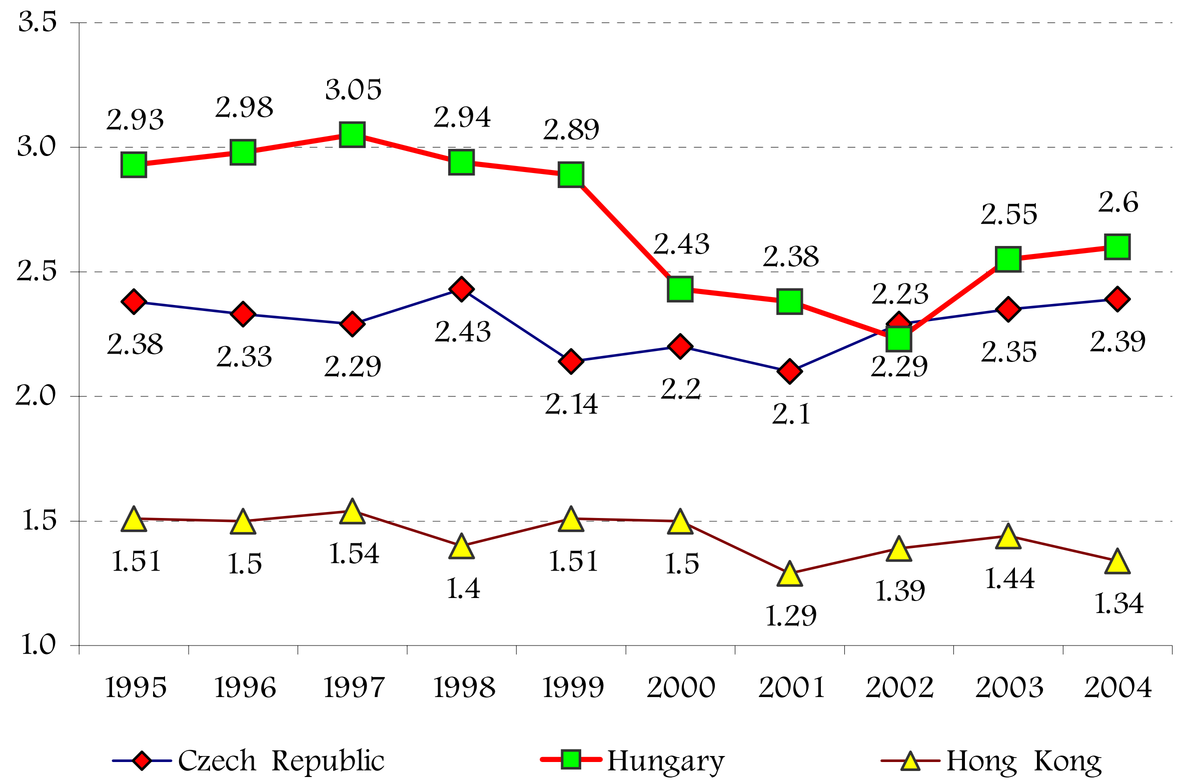
*Source:* Schwab, Porter and Sachs 2002.

Table 18
Frequency and extent of the 'bribe tax', %

| | Proportion of firms making bribes frequently | | Average bribe tax as proportion of firm's annual revenues | |
|---|---|---|---|---|
| | 1999 | 2002 | 1999 | 2002 |
| Czech Republic | 26.0 | 13.3 | 1.7 | 0.9 |
| Hungary | 32.3 | 22.6 | 0.9 | 1.0 |
| Poland | 33.2 | 18.6 | 0.7 | 1.2 |
| Slovakia | 33.6 | 36.0 | 1.3 | 1.4 |
| Slovenia* | 7.7 | 7.1 | 1.4 | 0.8 |
| Average of countries surveyed | | | 1.9 | 1.6 |

*Source:* Fries, Lysenko and Polanec 2003.
* Slovenia was the clearest of the countries in the survey.

Chart 1
Index of Economic Freedom, 1995–2004*




*Source:* Heritage Foundation (2004).
1 – freest countries, 5 – economically most repressed countries.
* Hong Kong was the leader throughout the period.

Table 19
Detailed scores in the IEF in 2003

| | Czech Republic | Hungary | Hong Kong |
|---|---|---|---|
| Overall grading | 2.39 | 2.6 | 1.51 |
| Rank | 32 | 42 | 1 |
| Category: | Mostly free | Mostly free | Free |
| Trade policy | 3 | 3 | 1 |
| Fiscal burden | 3.9 | 3 | 1.9 |
| Government intervention | 2.5 | 2 | 2 |
| Monetary policy | 1 | 3 | 1 |
| Foreign investment | 2 | 2 | 1 |
| Banking and finance | 1 | 2 | 1 |
| Wages and prices | 2 | 3 | 2 |
| Property rights | 2 | 2 | 1 |
| Regulation | 3 | 3 | 1 |
| Informal market* | 3.5 | 3 | 1.5 |

*Source:* Heritage Foundation 2004).
The scales run from 1–5. 1 – the economic environment or set of policies most conductive to economic freedom.
* The source was the Transparency International Corruption Perception Index (Heritage Foundation 2004), which it was not convenient to include in the earlier part of the paper.

Table 20
Economic freedom in the Czech Republic and Hungary in 1990, 1995, 2000 and 2001

| | Czech Republic | | | Hungary | | | |
|---|---|---|---|---|---|---|---|
| | 1995 | 2000 | 2001 | 1990* | 1995 | 2000 | 2001 |
| Overall score (placing) | 5.8 (68) | 6.8 (43) | 6.9 (39) | 5.0 (74) | 6.3 (46) | 6.6 (52) | 7.0 (35) |
| 1. Size of gov't | 3.1 | 4.6 | 4.5 | 2.9 | 4.7 | 4.8 | 4.7 |
| 2. Legal structure, security of property rights | 6.5 | 6.9 | 6.6 | 7.2 | 7.6 | 7.0 | 6.7 |
| 3. Access to sound money | 6.0 | 9.2 | 9.4 | 5.6 | 6.0 | 6.7 | 8.5 |
| 4. Freedom to exchange with foreigners | 7.8 | 7.8 | 8.1 | 4.8 | 7.0 | 7.4 | 8.5 |
| 5. Regulation of credit, labour and business | 5.4 | 5.7 | 5.8 | 4.6 | 6.0 | 7.0 | 6.6 |
| C. Regulation of businesses | 5.4 | 6.1 | 5.1 | | 6.0 | 7.3 | 5.8 |
| (i) Price controls | 6.0 | 4.0 | 7.0 | | 8.0 | 8.0 | 5.0 |
| (ii) Admin. obstacles for new businesses | | 7.8 | 2.7 | | | 7.4 | 3.8 |
| (iii) Time spent with gov't bureaucracy | 5.9 | 8.1 | 6.0 | | 6.1 | 6.2 | 6.5 |
| (iv) Ease of starting a new business | 6.0 | 5.5 | 4.5 | | 6.4 | 7.4 | 6.8 |

* There are no 1990 data for the Czech Republic.
Scores on a 10-point scale with higher numbers meaning greater economic freedom.

Table 21
Procedures for starting a business in January 2003

| | Number of procedures | Duration (days) | Cost (% of GNI p.c.) | Minimum capital (% of GNI p.c.) |
|---|---|---|---|---|
| Czech Republic | 10 | 88 | 11.7 | 110.0 |
| Hungary | 5 | 65 | 64.3 | 220.3 |
| Poland | 12 | 31 | 20.3 | 21.4 |
| Slovak Republic | 10 | 98 | 10.2 | 111.8 |
| Slovenia | 10 | 61 | 15.5 | 89.1 |
| Europe & Central Asia | 10 | 47 | 21.7 | 114.0 |
| OECD: High income | 7 | 30 | 10.2 | 61.2 |

*Source:* The World Bank group website.

Table 22
Statistics describing state regulations – scores and placings

| | Czech Republic | Hungary | Poland | Slovakia | Slovenia | Leader | Mean |
|---|---|---|---|---|---|---|---|
| 6.08 Regulation – administrative regulations in country are 1 = burdensome, 7 = not burdensome. | 3.4 (24) | 3.7 20) | 3.3 (30) | 3.0 (45) | 3.2 (36) | Hong Kong (5.9) | 3.3 |
| 6.10 Red tape – how much time firm's senior management spends working with gov't agencies or regulations. 1 = < 10% of time 2 = 10–20%, 8 = 71–80%. | 1.8 (13) | 2.5 (50) | 2.1 (39) | 3.2 (71) | 1.9 (20) | Japan (1.4) | 2.3 |
| 8.04 Administrative burden for start-ups – starting a new business in country is generally 1 = extremely difficult and time consuming, 7 = easy. | 4.3 (44) | 5.4 (16) | 5.2 (18) | 2.8 (72) | 4.4 (35) | Hong Kong (6.4) | 4.5 |
| 8.05 Permits to start a firm – how many permits needed (median response) | 4 (24) | 5 (35) | 3 (5) | 5 (35) | 5 (35) | Hong Kong (2) | 4.8 |
| 8.06 Days to start a firm – considering licence and permit requirements, typical number of days required to start a new firm in country? (median response) | 60 (54) | 45 (46) | 30 (19) | 60 (54) | 30 (19) | Iceland (5) | 40.2 |

*Source:* Schwab, Porter, Sachs, 2002.

Table 23
The burden of bureaucracy

| | Czech Republic | Hungary | Poland | Slovakia | Slovenia | Leader |
|---|---|---|---|---|---|---|
| 2.3.15 Bureaucracy: 0 = hinders 10= does not hinder business development. | 2.566(30) | 3.212 (23) | 1.714 45) | 1.538 (48) | 1.629 (47) | Singapore (6.687) |

*Source:* IIMD 2001.

Table 24
Chronology of selected reform measures in Hungary, Poland and Czechoslovakia

| Reform measures | Hungary | Poland | Czechoslovakia |
|---|---|---|---|
| Bankruptcy legislation | 1986 | 1983 | 1991, 1992 |
| Legislation on incorporated firms | 1989 | 1990 | 1991 |
| Abolition of mandatory plans | 1968 | 1982 | 1990 |
| First steps in price liberalization | 1968 | 1957, 1975 | 1991 |
| Entry into IMF and World Bank | 1982 | 1986 | 1990 |
| Considerable freedom to start a firm | 1982 | Unrestricted | 1991 |

*Source:* Kornai, 1996

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